United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-1067

~~74-8395~~

United States Court of Appeals

For the Second Circuit.

HUDSON TIRE MART, INC.,
Plaintiff-Appellant,

against

AETNA CASUALTY AND SURETY COMPANY,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT—
NORTHERN DISTRICT OF NEW YORK.

BRIEF FOR PLAINTIFF-APPELLANT.

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THE REPORTER COMPANY, INC., Walton, N. Y. 13856—607 865-4131—1975

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STATEMENT OF THE ISSUES

The issues before the Court on this appeal are: 1. Whether there is a state action present within the meaning of the Fourteenth Amendment and 42 U.S.C. 1983. 2. Whether the plaintiff's probability of succeeding on the merits is sufficient to warrant the issuance of a preliminary injunction. 3. Whether the plaintiff will suffer irreparable injury if a preliminary injunction is not issued.

A STATEMENT OF THE CASE

Plaintiff commenced this action by filing the complaint with the Clerk of the United States District Court for the Northern District of New York on November 25, 1974. The complaint alleges that the defendant seeks to conduct an examination of the plaintiff and other proceedings under color of state law pursuant to Section 168(6) of the Insurance Law of the State of New York and a contract of insurance entered into by the plaintiff and the defendant. The complaint alleges that such an examination if held would violate the due process clause of the Fourteenth Amendment of the United States. The complaint requests declaratory and injunctive relief pursuant to 28 U.S.C. 2201 and 42 U.S.C. 1983. Jurisdiction of the Court was alleged pursuant to 28 U.S.C. 1331 and 1343(3).

Plaintiff on November 26, 1974 made an application to the Hon.

James T. Foley, District Judge, for a temporary injunction pending determination of the application for a preliminary injunction restraining the defendant from examining the plaintiff as aforesaid. Judge Foley refused to grant a temporary injunction and scheduled a hearing on plaintiff's motion for a preliminary injunction for December 2, 1974. On December 2, 1974 Judge Foley denied the motion for a preliminary injunction, but granted a stay of proceedings until December 9, 1974, to allow the plaintiff to file a notice of appeal and apply to the United States Court of Appeals for the Second Circuit for an injunction pending appeal. The stay was extended by agreement of the parties to December 11, 1974.

Thereafter, plaintiff filed a notice of appeal and a bond for costs and applied to the United States Court of Appeals for the Second Circuit for an injunction pending appeal. In an order dated December 10, 1974, the Court of Appeals granted the injunction pending appeal.

Plaintiff now appeals to this court from the order of the Honorable James T. Foley, United States District Judge for the Northern District of New York, dated the 2nd day of December, 1974, which order denied plaintiff's motion for a preliminary injunction.

Facts:

Plaintiff is a New York corporation and is the insured under a policy of fire insurance issued by the defendant insurance company on or about November 1, 1973, effective on that date covering a period of one year and insuring the inventory and business of Hudson Tire Mart, Inc., located at 60 Fairview Avenue, Hudson, Columbia County, New York.

On or about May 29, 1974, the business owned by the plaintiff and

located at 60 Fairview Avenue, Hudson, Columbia County, New York sustained losses and damages occasioned by fire. Paul Di Stefano, a minority stockholder and officer of the plaintiff corporation, was indicted by the September, 1974 Term of the Columbia County Grand Jury for violating Section 150.10(1) of the Penal Law of the State of New York: to wit, Arson in the Third Degree, in regard to the fire that occurred on May 29, 1974 at the premises of the plaintiff.

Immediately after the indictment of the aforesaid Paul Di Stefano, the plaintiff received a notice from Aetna Casualty and Surety Company to examine the plaintiff by Paul Di Stefano. Thereafter, after certain civil proceedings had been commenced in the State of New York, Supreme Court, the parties stipulated that the plaintiff would appear by an unspecified agent for examination under oath on the 2nd day of December, 1974, reserving all rights to both parties to take any other actions they feel appropriate.

The plaintiff has now commenced this action seeking declaratory relief and preliminary and permanent injunctions restraining the defendant from examining the plaintiff and conducting other discovery proceedings pursuant to a clause of the standard form fire insurance policy of the State of New York hereinafter called the "Cooperation Clause". This clause provides that:

> The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described and submit to examinations under oath by any person named by this Company, and subscribe the same; and as often as may be reasonably required, shall produce for examination

> all books of account, bills, invoices and other vouchers, or certified copies thereof if originals be lost, at such reasonable time and place as may be disgnated by this Company or its representative, and shall permit extracts and copies thereof to be made.

The plaintiff contends that this clause operates to deprive the plaintiff of its property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States. Therefore, plaintiff requests that a preliminary injunction issue restraining the defendant from conducting an examination of the plaintiff before irreparable injury is inflicted on the plaintiff.

POINT I

THERE IS STATE ACTION PRESENT WITHIN THE MEANING OF THE FOURTEENTH AMENDMENT AND 42 U.S.C. 1983

Plaintiff's complaint sets forth two grounds for subject matter jurisdiction over this case, to wit: 28 U.S.C. 1331, and 28 U.S.C. 1343(3). The "civil action authorized by law" which is the required cognate to 28 U.S.C. 1343(3) jurisdiction, is claimed to be the Civil Rights Act, 42 U.S.C. 1983. Recognizing that both 42 U.S.C. 1983 and deprivations of due process under the Fourteenth Amendment require "state action" or action under "color of state law" and that these requirements have been held to be equivalent (Shirley v. State National Bank of Connecticut, 493 F. 2d 739 [2d Cir. 1974]), the remainder of this point will be directed to the issue of whether there is present here "state action".

The Court of Appeals for the Second Circuit in Bond v. Dentzer, 494 F. 2d 302 (1974), cert. denied 43 U.S. Law Week 3209, overruled the

District Court for the Northern District of New York and dismissed a lawsuit brought pursuant to 28 U.S.C. 1343(3) and 42 U.S.C. 1983 because it found no action under "color of state law". The plaintiff, Bond, challenged the constitutionality of Article 3A of the Personal Property Law of New York (McKinney 1962) which governs wage assignment provisions in creditor-debtor security agreements. That article regulated garnishment of wages without requiring any notice to the debtor before the garnishment was perfected.

The Court of Appeals found that state action could not be sustained on either "partnership", "encouragement", or "traditional state functions" theories. The Court found no "partnership" because while the defendant banks were licensed under Article 9 of the Banking Law of the State of New York (McKinney's 1971), "this is true of every corporation chartered under a special or general incorporation statute" and the State . . . does not receive any revenue from the licensing of lenders, and the finance companies, in any event, do not enjoy any monopoly in the lending of money on the security of wage assignments." Furthermore, the Court pointed out that the regulations set forth in Article 3A of the Personal Property Law and Article 9 of the Banking Law were "conspicuously and designedly for the benefit of the borrower and not the lender." 494 F. 2d at 306.

The Court found the "encouragement" theory inapplicable because Article 3A was primarily concerned with the protection of the wage earner-assignor. The Court said:

> The fact that the statute provides that only wage assignments made pur suant to Article 3A are collectable is merely a recognition of what had been true at common law before

Otherwise any insurer may be able to escape liability when

> the statute was enacted except that procedural and substantive safeguards were provided to protect the wage earner from loan shark techniques . . .
>
> In this context the phrase "contract of adhesion." becomes meaningless. 494 F. 2d at 306.

The Court also disposed of the "traditional state functions" theory on the same basis - that is, that the state had "not intruded at all in the so-called offensive conduct complained of here, but rather has regulated the terms of the arrangement to prevent the gouging of the impecunious." 494 F. 2d at 311.

We submit that the relationship between the State and the insurance industry and the differences between the statute involved in the case at bar, Section 168 of the Insurance Law of New York (McKinney 1966), and the statute involved in Bond make Bond distinguishable from the case at bar and requires this Court to find State action based on both the "partnership" and "encouragement" theories.

The insurance industry in New York is a highly regulated one. Not only does the State license insurance companies and regulate their organization (Article 4 of the Insurance Law), but in the largest collection of statutes directed at one industry it regulates, among other things, the assets and investments of insurance companies (Article 5 of the Insurance Law), the rates that companies may charge for their policies (Article 8 of the Insurance Law), and the provisions that insurance contracts may contain (Article 7 of the Insurance Law). Indeed, in New York, the person desiring fire insurance can only buy one policy and that policy is set forth and mandated by Section 168(6) of the Insurance Law.

Moreover, the State of New York and its municipal subdivisions derive substantial revenue from licensing of insurance companies and the sale of insurance policies. The lack of a substantial connection between the licensing of lendors and the production of State revenue was a major factor utilized by the Court of Appeals in Bond, to distinguish Bond from Seidenberg v. McSorley's Old Ale House, Inc., 317 F. Sup. 593 (SDNY 1970). 494 F. 2d at 306.

New York imposes a tax on insurance companies equal to a percentage of the company's net income derived from business conducted in New York. New York Tax Law Section 1502 (McKinney's 1966 as supplemented). Additionally, all insurance companies must pay a tax equal to a percentage of premiums written on risks located or resident in New York; New York Tax Law Section 1510 (McKinney's 1966 as supplemented). Foreign and alien insurers, as defined by Section 4 of the New York Insurance Law (McKinney's 1966), which includes the defendant, Aetna Casualty and Surety Company, must pay additional taxes equal to a percentage of their premiums written on property that is located or resident in New York; New York Insurance Law Section 552 (McKinney's 1966 as supplemented). And still further, foreign and alien insurance companies insuring against fire loss must pay to the fire department of a municipality, fire district or territory, a tax equal to a percentage of the companies' premiums written on property located in such city, village, fire district or territory, New York Insurance Law Section 553 (McKinney's 1966). To lessen this tax burden, taxes paid under Section 553 or 554 of the Insurance Law are credited

against taxes due under Article 33 of the Tax Law; N.Y. Tax Law Section 1511 (McKinney's 1966 as supplemented).

As a result of these taxes, New York has a very real interest in assuring that the New York fire insurance market is a desirable one for insurance companies and seeing to it that premium sales and net profits of insurance companies are maintained. The state interest and entwinement in the success of insurance companies is somewhat stronger than the state interest in the success of licensed lenders, or any other chartered corporations.

A case directly in point is Stern v. Massachusetts Indemnity and Life Insurance Co., 365 F. Supp. 433 (E.D. Pa. 1973). In that case, the plaintiff brought a civil rights action alleging that the defendant insurer refused to sell to women disability insurance containing the same terms and conditions as that sold to men and that this refusal was solely on the basis of sex. The District Court rejected the defendant insurance company's defense that the plaintiff failed to show "that anyone acted under color of state law." The court distinguished Moose Lodge No. 107 v. Irvis, 407 U.S. 163, 92 S. Ct. 1965, 32 L Ed 2d 627 (1972) as follows:

> In Irvis it was found that the Pennsylvania Liquor Control Board played no part in establishing or enforcing membership or guest provisions of the private club and neither approved nor endorsed the club's racially discriminatory practices. But here the involvement of the state is unequivocal. Not only does the state license insurance companies desiring to sell policies in Pennsylvania, it also approves such policies and classifications of risks before they can be used. No insurance company is permitted to sell any policy in the state until it has been approved by the state insurance department pursuant to authority granted by the Commonwealth. 365 F. Supp.

at 438.

The Court went on to hold:

> In light of the pervasive regulatory scheme extant here, we find that the allegations of the complaint sufficiently set forth the requirement of state action. 365 F. Supp. at 439.

The nature of the particular statute involved here - Section 168(6) of the Insurance Law and more particularly, the "Cooperation Clause", requires a finding of state action.

There is only one fire insurance policy that a person can buy in New York and the provisions of that fire insurance policy are mandated by the State. Insurance companies, unlike the finance companies involved in Bond, do have a monopoly.

Moreover, the "Cooperation Clause", unlike Article 3A of the Personal Property Law, or the Connecticut statute under judicial scrutiny in Shirley, supra, cannot be said to have been enacted for the benefit of the insured. The clause is solely for the benefit of the insurer allowing it to conduct full pre-trial disclosure and discovery proceedings without affording the insured the benefit of protections that he would otherwise be afforded in the context of a plenary action and outlined in Article 31 of the New York Civil Practice Law and Rules (McKinney 1970) or Rules 26 and 37 of the Federal Rules of Civil Procedure (see Point II, infra).

The standard form fire insurance policy and the "Cooperation Clause" can, unlike the provisions imposed by Article 3A of the Personal Property Law, be said to be a contract of adhesion imposed by the State. Article 3A of the Personal Property Law did not require a borrower to agree

to a wage assignment in order to borrow funds. Rather, if a borrower agreed to a wage assignment as security for his debt, Article 3A imposes certain requirements which act to protect the borrower, Section 168(6) of the Insurance Law does require that one seeking insurance agree to all the provisions of a State imposed standard form contract - the "Cooperation Clause" of which operates to deprive the insured of certain due process requirements which would otherwise inure to the insured's benefit.

It is not relevant to argue, as did the defendant in the court below (see defendant's Memorandum of Law at page 12), that "[i]n view of the respective bargaining positions of the parties, it is unlikely that an insured, absent a standard policy form, could insist upon what particular terms and provisions were to be contained in the policy of insurance." The fact is that it is the State of New York which is dictating the terms of the policy.

Furthermore, even assuming that the insurance companies could dictate all the terms of a fire policy absent state legislation, and assuming that the insurance companies would dictate terms similar to that of the "Cooperation Clause", the courts of New York might refuse to enforce such a condition under the doctrine of unconscionability. See, e.g., New York Uniform Commercial Code Section 2-302 (McKinney's 1964); Campbell Soup v. Wentz, 172 F. 2d 80 (3d Cir. 1948); Williams v. Walker-Thomas Furniture Co., 350 F. 2d 455 (D.C. Cir. 1965). The New York Courts also might refuse to enforce such a condition by application of a public policy argument. See, e.g., Sternamen v. Metropolitan Life Ins. Co., 170 N.Y. 13, 62 NE 763 (1902); Linn v. Radio Center Delicatessen, Inc., 169 Misc.

879, 9 NYS 2d 110 (Mun. Ct. 1939).

The fact that New York mandates a standard form policy with a "Cooperation Clause" immunizes the "Cooperation Clause" from attack on all but constitutional grounds. It is this immunization and the encouragement that stems therefrom that the Supreme Court found offensive in Reitman v. Mulkey, 387 U.S. 369, 377, 18 L ed 2d 830, 87 S Ct 1627 (1967).

Because of the distinctions between the statutes involved in the case at bar and the statutes involved in Bond, the Court should accept subject matter jurisdiction based upon the state action theories outlined in Bond v. Dentzer, 362 F. Supp. 1373 (NDNY 1973), and applied in Stern, supra.

> Although the mere existance of a state or federal regulatory scheme is not sufficient to bring those regulated within the scope of the Fourteenth Amendment . . . the regulation and its extent must be considered in weighing the circumstances of each case. (Citation omitted). Male v. Crossroads Associates, 469 F. 2d 616, 621 (2d Cir. 1972).

POINT II

THE PROBABILITY OF SUCCESS ON THE MERITS IS SUFFICIENT TO PERMIT THE COURT TO GRANT A PRELIMINARY INJUNCTION

The "Cooperation Clause" of the standard form fire insurance contract has been construed by the courts of the State of New York to be a condition precedent to recovery under the terms of a fire insurance contract. A breach of the "Cooperation Clause" results in the default by the insured under the contract and bars him from recovery; Hallas v. North River Ins. Co., 279 AD 15, 107 NYS 2d 359 (1st Dept. 1951) affd 304 NY 671, 107 NE 2d 592 (1952); Gross v. U.S. Fire Ins. Co., 71 Misc. 2d 815, 337 N.Y.S. 2d 221 (Kings

County 1972); Restina v. Aetna Cas. & Sur. Co., 61 Misc. 2d 574, 306 N.Y.S. 2d 219 (Schen. County 1969).

The "Cooperation Clause" actually provides for discovery and disclosure devices in the context of litigation which is not yet commenced but which looms large upon the horizon; thus the "Cooperation Clause" must be subject to the same due process safeguards required for discovery and disclosure in a plenary suit. These safeguards are incorporated into Article 31 of the New York Civil Practice Law and Rules 26 and 37 of the Federal Rules of Civil Procedure. See generally, Annotation, "Discovery-Disobedience-Default Judgment", 144 ALR 372, 376-94 (1943).

In Hovey v. Elliot, 167 U.S. 409, 42 L ed 215, 17 S. Ct. 841, (1897), the Supreme Court laid down the following general proposition regarding default for failure to produce evidence:

> [A] more fundamental question that remains to be determined, that is, whether a court possessing plenary power to punish for contempt, unlimited by statute, has the right to summon a defendant to answer, and then after obtaining jurisdiction by the summons, refuse to allow the party summoned to answer to or strike his answer from the files, suppress the testimony in his favor, and condemn him without consideration thereof and without a hearing, on the theory that he has been guilty of a contempt of court. The mere statement of this proposition would seem, in reason and conscience, to render imperative a negative answer. The fundamental conception of a court of justice is a condemnation only after hearing. To say the courts have inherent power to deny all right to defend an action and to render decrees without any hearing whatever is, in the very nature of things, to convert the court exercising such authority into an instrument of wrong and oppression and hence to strip it of that attribute of justice upon which the exercise of judicial power necessarily depends. 167 U.S. at 413-414.

The Supreme Court in Hammond Packing Co. v. Arkansas, 212 U.S.

322, 53 L ed 530, 90 S. Ct. 370 (1909) explained and distinguished Hovey. The Supreme Court upheld an Arkansas statute allowing the court to strike out a party's answer and pleadings for failure to comply with an order to produce documents on the ground that the order to strike was based on the judicial presumption that arises from the failure to produce evidence (as opposed to the mere exaction of a penalty for failure to comply with a court order).

The rule of law that is deduced from a reading of Hammond and Hovey, is that:

> an application of such a statute which goes beyond the preclusion of the proof that might presumptively be discovered if the papers were produced transgresses the constitutional limitations of due process. 144 ALR at 379. See also, Societe Internationale v. Rogers, 357 U.S. 197, 209-10, 2 L ed 2d 1255, 78 S Ct. 1087.

The New York Courts have followed the rules set forth in Hovey and Hammond. In People v. George Henriques and Co., 267 N.Y. 398, 196 NE 304 (1935), the Court of Appeals reversed a judgment granted to the People after the defendant's answer was struck for failure to comply with an order of the Court to produce papers and documents. The order to produce was obtained by the People pursuant to Article 23-A of the New York General Business Law authorizing the attorney-general to obtain an order to produce papers and documents and to appear for examination concerning alleged fraudulent practices before the commencement of an action.

The Court of Appeals in reversing the judgment said:

> The limitation upon the power of a court to strike out an answer and to grant judgment pro confesso as punishment for disobedience of its mandate to produce

> evidence is inherent in the nature of the judicial function. It may exercise the power only in aid of its function to determine the truth of the charges made, after due consideration and after opportunity for a hearing accorded to all parties (Feingold v. Walworth Bros., Inc., 238 N.Y. 446). The test in each case is whether refusal to produce evidence sustains the findings of the court. 267 N.Y. at 403.

In Davidoff v. Kaplan, 209 App Div 592 (1st Dept. 1924), the Court reversed a lower court order striking defendant's answer for failure to comply with an order to produce books and documents, holding:

> We are of the opinion that the penalty enforced in this case should be resorted to only where there is a clear and deliberate attempt to impede justice or to suppress evidence. In such a case it should be unhesitatingly resorted to, but, where there is a question as to the ability to the litigant against whom an order is made to comply therewith, his pleadings should not be stricken out until his power to comply with the order has been satisfactorily demonstrated. 209 App Div at 594-95.

Other jurisdictions have also recognized the constitutional limitation on the court's power to impose sanctions for failure to disclose evidence. See, e.g., Baltimore Transit Company v. Mezzanotti, 227 Md 8, 174 A. 2d 768 (1961); Anderson v. Stanwood, 178 Or 306, 167 P. 2d 315 (1946); Caryl Richards, Inc. v. Superior Court of Los Angeles County, 188 Cal App 2d 300, 10 Cal Rptr 377.

The Federal Rules of Civil Procedure and New York Civil Practice Laws and Rules both incorporate due process safeguards into their discovery proceedings. Rule 26(c) of the Federal Rules allows a party from whom discovery is being sought to move for protective orders on a number of grounds. New York Civil Practice Law and Rules Section 3103 provides the same protection. Rule 37(b) of the Federal Rules of Civil Procedure allows

the Court to impose sanctions only after the party seeking discovery has obtained a court order providing for discovery. The party objecting to discovery would have an opportunity to present his objections on the application for the order. New York Civil Practice Law and Rules provides for similar procedures. (N.Y. CPLR 3124, 3126).

The "Cooperation Clause" of the standard form fire insurance policy is a circumvention of the due process rules formulated in the case law and incorporated into the discovery proceedings pursuant to practice rules. Its breach has been construed by the New York Courts (see Gross and Restina, supra) to preclude recovery under an insurance contract without examination into the relationship between the evidence not produced and the issues resolved against the insured. In so doing, it deprives the insured of property, its claim under the contract of insurance, without due process of law.

Plaintiff respectfully submits that Judge Foley avoided the basis of the due process objections in this case when he wrote in his Memorandum Decision that " t he fact must be faced that if and when the plaintiff company chooses to sue on the insurance policy it will face in the state or federal court system liberal pre-trial depositions and discovery procedures." (see Appendix at page 31). Plaintiff would be more than happy to subject itself to the discovery procedures of the federal and state court system because, as was pointed out above, these liberal procedures also contain ample protective devices against the imposition of sanctions for nondisclosure.

While it is true, as Judge Foley pointed out in his Memorandum

Decision (See Appendix at page 31), that the questioning under the insurance policy cannot prevent the institution of a suit by the plaintiff, he ignored the fact that the willful or unreasonable failure to answer questions is a material breach of the insurance contract which bars recovery. See the Hallas, Gross and Restina cases cited supra. Consequently, the merits of the insured's claim is never reached. A bare right to institute a suit to recover is meaningless if the ultimate right to recover is barred.

The defendant in its Memorandum of Law in opposition to the motion for a preliminary injunction (pages 17-19 of the Memorandum) cites numerous cases as confirming the validity and reasonableness of cooperation clauses, but none of the cases cited and no cases which plaintiff's research has disclosed have ever considered the constitutionality of such a clause on due process grounds.

Judge Foley in his Memorandum Decision (see Appendix at page 31) cited two cases for the proposition that insurance companies have the right to question their insureds. Such statement is merely an exercise in circular reasoning. (Insurance companies have the right to examine insureds because statutes or contracts give them such a right. Statutes or contracts enunciating the right of an insurance company to examine the insureds are valid because the insurance companies have such a right). It does not dispose of the issue of the constitutionality of a state mandated cooperation clause.

While plaintiff would concede that examinations of insureds do serve a valid function in the settlement and disposition of insurance claims,

this purpose would be equally well served, and not at the expense of the due process rights of insureds, if the protective provisions contained in the Federal Rules of Civil Procedure or the New York Civil Practice Law and Rules were incorporated into the "Cooperation Clause".

POINT III

THE DENIAL OF A PRELIMINARY INJUNCTION WOULD RESULT IN IRREPARABLE INJURY TO THE PLAINTIFF

As set forth in the complaint, (see Appendix at page 7), a minority stockholder and officer of the insured corporation, Paul Di Stefano, has been charged with arson in the third degree for allegedly setting the fire for which the insured plaintiff seeks recovery under its policy of fire insurance with the defendant insurer. The likelihood of the assertion of the defense of arson to the plaintiff's claim under the insurance policy certainly must be considered a strong possibility under these circumstances.

The defendant did not bother to serve a notice on the insured to appear for examination under oath until after Paul Di Stefano had been indicted by a Grand Jury in October of 1974. The fire occurred on May 29, 1974. Immediately after the indictment had been returned, the plaintiff received a notice from Aetna Casualty and Surety Company to examine the plaintiff by Paul Di Stefano. See paragraph 8 of the complaint (Appendix at page 7).

The attorney for Paul Di Stefano in the criminal proceeding, George J. Pulver, Jr., has indicated that he would not allow Paul Di Stefano to appear at any such hearing until the disposition of the criminal charge and

that Paul Di Stefano would refuse to appear and testify in the exercise of his constitutional right against self-incrimination. When George J. Pulver, Jr., requested an adjournment of the examination, Francis J. Holloway, attorney and agent for the defendant, stated that he would construe the failure to appear as a material breach of the insurance policy by the insured, Hudson Tire Mart, Inc., and would disclaim liability for indemnity for the fire loss. An affidavit by George J. Pulver, Jr., sworn to on the 18th day of October, 1974, which recites these facts was annexed to this brief on the motion for a preliminary injunction. See Record on Appeal.

Only after the insured, Hudson Tire Mart, Inc., had commenced an action in New York Supreme Court for declaratory and injunctive relief on the ground, among others, that the insured could not name the agent of the corporation to be examined in the first instance, did the defendant stipulate to serve a notice upon the company without specifying the agent, and reserving all rights to serve further notices of examination. The stipulation to this effect is annexed to the complaint herein as Exhibit C. (See Appendix at page 16).

It is apparent that the defendant is trying to back the plaintiff into a position where it would be in default of the "Cooperation Clause" of the insurance policy and would therefore be denied an opportunity to recover under the terms of the policy. There is nothing to prevent the defendant from serving a notice to examine Hudson Tire Mart, Inc., by Paul Di Stefano, immediately after the examination of the plaintiff by an agent of the plaintiff's own choosing. This is the exact problem with the

"Cooperation Clause", and this is precisely why plaintiff feels that there is great danger that it will be deprived of its right to claim indemnity under the contract of insurance without due process of law.

If the examination was in the context of an examination before trial pursuant to Article 31 of the New York Civil Practice Law and Rules, the plaintiff would have an opportunity to apply for a protective order, and would be able to get a court determination as to exactly what is must disclose and what it need not disclose before sanctions could be taken against it for failure to comply with the discovery proceedings. The plaintiff under the standard form fire insurance policy has no such opportunity. It alone must bear the entire risk of deciding whether or not a decision to ignore a notice for examination or a decision not to answer specific questions presented to it at an examination will be construed to be an unreasonable failure to disclose and a material breach of the insurance contract.

The consequences of a wrong guess by the insured are disastrous. Under circumstances similar to those in the case at bar, the insured has been held to have breached the policy and has been denied recovery by the New York Courts. Gross v. U.S. Fire Ins. Co., 71 Misc. 2d 815, 337 N.Y.S. 2d 221 (Kings County 1972); Restina v. Aetna Cas. and Sur. Co., 61 Misc. 2d 574, 306 N.Y.S. 2d 219 (Schen. County 1969).

The unfortunate consequences that the Gross and Restina decisions may hold for insureds was recognized by the editors of Appleman Insurance Law and Practice. In criticizing the Restina decision, the editors wrote:

> Would it not be better to allow the insured to recover if you can show the insurer suffered no prejudice from the delay?

> Otherwise any insurer may be able to escape liability whenever its insurer [sic] is falsely accused of arson and happens to have a capable criminal attorney. 5 Appleman Insurance Law and Practice Section 3549 n. 54 (1974 supplement).

The rather obvious but deadly game that the defendant insurance company is playing in the case at bar was thus clearly predicted.

The defendant will suffer no harm if the preliminary injunction requested by the plaintiff is granted. The insured's ability to defend a lawsuit instituted by the plaintiff to recover under the policy will in no way be affected. The plaintiff will still be available for examination to answer any questions the insurer might have if and when it is adjudged that the plaintiff is not entitled to a preliminary injunction in this case. The defendant has already been afforded the opportunity to examine the remains of the fire, and it has been supplied with an inventory and appraisal by a fire adjuster. It is rather difficult to see where a time delay in the examination of the insured will prejudice the defendant.

Nor can the delay in examination adversely affect the liability of the insurer. The standard form of fire insurance policy of New York limits the liability of the insured to the "actual cash value of the property at the time of the loss . . . . " (emphasis supplied). Therefore, mere passage of time cannot increase the liability of the defendant. While interest is recoverable by the insured on the amount due to it on a fire claim, the insurer collects that very interest on the money he owes to the insured while the money is in the insurer's possession.

CONCLUSION

THERE IS STATE ACTION PRESENT WITHIN THE MEANING OF THE FOURTEENTH AMENDMENT AND 42 U.S.C. 1983. PLAINTIFF HAVING SHOWN THE PROBABILITY OF SUCCESS ON THE MERITS AND THAT IRREPARABLE INJURY MAY RESULT UNLESS THE DEFENDANT IS ENJOINED FROM CONDUCTING DISCOVERY PROCEEDINGS AUTHORIZED BY SECTION 168(5) OF THE NEW YORK INSURANCE LAW, A PRELIMINARY INJUNCTION RESTRAINING SUCH ACTION SHOULD ISSUE.

Respectfully submitted,

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